

### DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE WASHINGTON, D.C. 20224

Date:

JUN 17 2013

Linda L. Jefferson Director, Portland Bureau of FPDR 1800 SW 1<sup>st</sup> Avenue, Suite 450 Portland, OR 97201 Local contact address: Internal Revenue Service SE:T:EP:RA:VC:Group 7553 1555 Poydras Street Suite 220, MDP 17 New Orleans, LA 70112

Compliance Statement for: City of Portland Fire and Police Disability and Retirement Plan

Control Number: 911725096

Employer Identification Number: 93-6002236 Plan No.: 001

Dear Ms. Jefferson:

Enclosed is your compliance statement. A compliance statement constitutes an enforcement resolution solely with respect to certain failures of an employee retirement plan that is intended to satisfy the requirements of the Internal Revenue Code. It does not constitute a ruling letter within the meaning of Revenue Procedure 2013-4, 2013-1 I.R.B. 126, or a determination letter within the meaning of Revenue Procedure 2013-6, 2013-1 I.R.B. 198. The compliance statement should not be construed as affecting the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974.

At a later date, you may be required to verify that the correction of the failures and any modification of administrative procedures (upon which your enforcement resolution is conditioned) have been timely made.

Copies of this compliance statement and of this letter have been sent to your authorized representative in accordance with a power of attorney or other authorization on file in this office. If you have any questions, please contact Felecia Porée, ID # 1000341177 by phone at (504) 558-3139 or by fax at (504) 558-3189.

Sincerely.

Manager, Employee Plans Voluntary Compliance

Enclosure(s):

Compliance Statement – Form 8950 Cc: Lorne O. Dauenhauer, Esq.

Plan Name: City of Portland Fire and Police Disability and Retirement Fund EIN: 93-6002236 Plan #: 001

### SECTION I. PLAN INFORMATION

1. APPLICANT'S NAME: City of Portland

2. APPLICANT'S EIN: 93-6002236

3. PLAN NO. 001

4. PLAN NAME: City of Portland Fire and Police Disability and Retirement Fund

### SECTION II. APPLICANT'S DESCRIPTION OF FAILURES

See attachment entitled "SECTION II. APPLICANT'S DESCRIPTION OF FAILURES."

### SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION

See attachment entitled "SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION."

## SECTION IV. APPLICANT'S PROPOSED PROCEDURES TO LOCATE AND NOTIFY FORMER EMPLOYEES OR BENEFICIARIES

All affected former employees and beneficiaries have been located. Several communications have been sent out to these individuals. Individuals whose recoupments are to be capped at 60% are represented by attorneys as a class.

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### SECTION V. APPLICANT'S PROPOSED REVISION TO ADMINISTRATIVE PROCEDURES

The City has previously corrected the manner in which current and future Plan pension, death and disability benefits are calculated and currently believes that all such calculations are being determined in full accordance with the requirements of the Plan's document. Moreover, the Plan has engaged the services of a Pension Management Consultant who, among other things, evaluated the Plan's operations and made recommendations concerning improvements of the Plan's existing pension management practices, including possible administrative procedure and systems changes. Those persons responsible for Plan administration believe that the work performed by this Pension Management Consultant will facilitate the identification of any deficiencies or weaknesses in the Plan's existing procedures in order to improve those procedures and thereby prevent future Operational Failures.

### SECTION VI. REQUESTS RELATED TO EXCISE TAXES, ADDITIONAL TAX, AND TAX REPORTING

Under t		plicant requests that the Internal Revenue Service ("Service") not pursue the following taxes all Revenue Code ("Code") (attach supporting rationale as required by section 6.09 of Rev. Proc.
2013-1		iar Revenue Code (Code ) (attach supporting rationale as required by section 6.09 of Rev. Proc
		Excise tax under Code section 4972 with respect to failure(s) #
		Excise tax under Code section 4973 with respect to failure(s) #
	<u> </u>	Excise tax under Code section 4974 with respect to failure(s) #
		Excise tax under Code section 4979 with respect to failure(s) #
		Imposition of additional tax under Code section 72(t) with respect to failure(s) #
<b>□</b>		plicant requests that the Service grant the following with respect to plan loan failures as ed in section 6.07 of Rev. Proc. 2013-12:
		With respect to failure(s) #, that a deemed distribution corrected pursuant to this VCP submission not be required to be reported on Form 1099-R and that repayments made by such
		correction not result in the affected participant having additional basis in the plan for purposes
		of determining the tax treatment of subsequent distributions from the plan.  With respect to failure(s) #, that a deemed distribution be reported on Form 1099-R with respect to affected participants for the year of correction instead of the year of the failure.

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### SECTION VII. ENFORCEMENT RESOLUTION (to be completed by IRS only)

The Applicant will neither attempt to nor otherwise amortize, deduct, or recover from the Service any portion of the compliance fee nor receive any Federal tax benefit on account of payment of such compliance fee.

The Service will not pursue the sanction of revoking the tax-favored status of the plan under § 401(a), 403(b), 408(k), or 408(p) of the Internal Revenue Code ("Code") on account of the failure(s) described in this submission. This compliance statement considers only the acceptability of the correction method(s) and the revision(s) of administrative procedures described in the submission and does not express an opinion as to the accuracy or acceptability of any calculations or other materials submitted with the submission. The reliance provided by this compliance statement is limited to the specific failures and years specified and does not provide reliance for any other failure or year. In no event may this compliance statement be relied on for the purpose of concluding that the plan or Plan Sponsor was not a party to an abusive tax avoidance transaction. The compliance statement should not be construed as affecting the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974.

This compliance statement is conditioned on (1) there being no misstatement or omission of material facts in connection with the submission and (2) the completion of all corrections described in this compliance statement within one hundred fifty (150) days of the date of the compliance statement.

The Service will treat the failure to adopt interim amendments or amendments for optional law changes, as described in section 6.05(3)(a) of Rev. Proc. 2013-12 as if they had been adopted timely for the purpose of making available the extended remedial amendment period currently set forth in Revenue Procedure 2007-44, 2007-2 C.B. 54, or its successors. However, this compliance statement does not constitute a determination as to whether any such plan amendments, as drafted, comply with the applicable changes in qualification requirements.
With regard to failure # relating to the 403(b) Plan failure to timely adopt a written plan, as required under the final § 403(b) regulations and Notice 2009-3, the Service will treat the written plan as if it had been adopted timely for the purposes of making available the extended remedial amendment period set forth in Announcement 2009-89. However, this compliance statement does not constitute a determination as to whether the written plan, as drafted, complies with the applicable requirements associated with § 403(b) and the final § 403(b) regulations.
With regard to failure # (provided that no modification has been made to either the plan document or adoption agreement of the plan that would otherwise cause the employer to lose reliance on the plan's opinion or advisory letter), the corrective amendment will not cause the plan to lose its status as a Master or Prototype plan or Volume Submitter plan and (provided that no modification has been made that would otherwise affect the employer's eligibility for the six-year remedial amendment cycle) the employer will be allowed to remain within the six-year remedial amendment cycle described in Revenue Procedure 2007-44, 2007-2, on a continuing basis until the expiration of the next six-year remedial amendment cycle as provided in section 18.01 of Rev. Proc. 2007-44, or, if different, the deadline announced by the Service, as provided in section 18.03 of that revenue procedure. In addition, the issuance of this compliance statement constitutes a determination of the effect of the corrective plan amendment on the qualification of the plan, and a subsequent filing of a determination letter request on such amendment will not be required until the expiration of the next six-year remedial amendment cycle.

Ρl	an Name	: City of Portland Fire and Police Disability and Retirement Fund EIN: 93-6002236 Plan #: 001						
	rvice will not pursue the following on account of the qualification failure(s) described in this sion:							
	0000	Excise tax under Code section 4972.  Excise tax under Code section 4973.  Excise tax under Code section 4974.  Excise tax under Code section 4979.  With respect to the Overpayment failures described in this submission that were corrected by removing improper distributions from the IRA(s) of the affected participant(s) and returning those distributions to the plan, the Service will not pursue % of the 10% additional income tax under Code § 72(t).						
	With re	th respect to the loan failure(s) described in this submission:						
		Loan(s) that are corrected in accordance with one of the methods described in section 6.07(2) of 6.07(3) of Rev. Proc. 2013-12: The Service will not require deemed distributions under Code § 72(p) to be reported on Form 1099-R with respect to the participant(s) affected by the failure(s) and repayments made pursuant to the correction of such loan(s) will not result in an affected participant having additional basis in the plan for the purpose of determining the tax treatment of subsequent distributions from the plan to such participant(s).						
		Loan(s) that are not being corrected in accordance with one of the methods described in section 6.07(2) or 6.07(3) of Rev. Proc. 2013-12: The Service will require deemed distributions under Code § 72(p) to be reported on Form 1099-R with respect to the participant(s) affected by the failure(s). However, the plan will be permitted to report deemed distributions on Form 1099-R in the pear of correction, i stead of the year of the failure.						
Approv	/ed:	Yan Mak						
- of have		Manager, Employee Plans Voluntary Compliance Tax Exempt and Government Entities Division						
Date: _	JUN	<del>17 2013</del>						

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#### SECTION II. APPLICANT'S DESCRIPTION OF FAILURES

The City of Portland Fire and Police Disability and Retirement Fund (the "Plan") is an unfunded, defined benefit pension plan sponsored by the City of Portland, a municipality of the State of Oregon. The Plan's document is found in Chapter 5 of the Charter of the City of Portland (the "Charter"). The Plan is sponsored by the City of Portland (the "City"), and is a governmental plan within the meaning of Code section 414(d) and, pursuant to Section 5-402 of the Charter, is intended to meet the requirements for tax-qualified status under Code section 401(a).

The City filed a VCP application with respect to the Plan on July 7, 2009 (the "Original VCP Application"). A copy of the initial Original VCP Application is enclosed for reference (note: attachments to the Original VCP Application that related to the contemporaneous Determination Letter application have been omitted due to (i) irrelevance and (ii) length (that portion of the submission totaled more than 200 pages).

The Original VCP application covered (1) a series of operational failures arising due to the overpayment of benefits for approximately 919 participants and beneficiaries and (2) a number of plan document failures arising due to the untimely adoption of amendments required to keep the Plan in compliance with applicable tax-qualification requirements.

The facts and details underlying the operational failures are as set forth in the Original VCP application, which is attached to this application; the facts and details outlined therein have not changed.

The Original VCP application as initially filed with IRS requested a compliance statement that would not require recoupment of the overpaid benefits (i) because the Plan is completely unfunded, so the overpayment of benefits did not come from trust funds that would otherwise affect other pensioners' benefits and (ii) because the City anticipated that any attempts to recoup the overpayments from overpaid Plan participants would result in costly litigation that would, at the end of the day, cost the City's taxpayers a considerable amount of money in terms of legal expenses.

IRS refused to approve the Original VCP application as initially filed because the proposed correction method did not offer a "correction method" for the past overpayments, and the reviewing agent indicated that under EPCRS IRS was not authorized to approve correction methods that did not involve some sort of correction.

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## SECTION II. APPLICANT'S DESCRIPTION OF FAILURES (continued)

As to the City's position that a prospective recoupment of the overpayments would trigger costly litigation, the IRS indicated that it could not take "what ifs" into consideration when determining appropriate relief under EPCRS: the City was told that if and when litigation occurred with respect to an IRS-approved correction method, the City could re-file a VCP application asking for additional relief. See August 5, 2010, letter from IRS, a copy of which is enclosed for reference.<sup>1</sup>

Accordingly, the City revised the Original VCP Application to provide for recovery of overpaid benefits (the "Revised VCP Application"). See Section II of the Revised VCP Application, as submitted to IRS on October 25, 2010, which is incorporated into the Compliance Statement issued by IRS on December 21, 2010 (the "Compliance Statement"). A copy of the 2010 Compliance Statement is enclosed for reference.

Subsequent to the issuance of the 2010 Compliance Statement, the Plan fully implemented the overpayment recoupment correction methodology set forth in the Revised VCP Application.

As anticipated, the Plan's recoupment of the overpaid benefits resulted in litigation against the City and the Plan. To date, most of the decisions made by the court in this litigation have run in the favor of the overpaid participants. The court encouraged the parties to obtain a settlement to avoid additional litigation.

The parties engaged in a mediation session on February 5, 2013 in which the City and the overpaid individuals reached tentative agreement — contingent on the City's obtaining of approval of this proposed settlement through a subsequent VCP application.

With all that as background, we respectfully request that the IRS consider approving the correction methodology set forth in Section II below.

<sup>&</sup>lt;sup>1</sup> This letter stated, in pertinent part, that "With respect to the question, what if recoupment is legally challenged, the Service can not comment on "what if" other than if the correction is not completed the compliance statement will not be valid and the plan will no longer be qualified. If it is later determined that the plan can not recoup the excess benefit due to (actual) legal reasons, then at that time the plan sponsor can resubmit to VC to seek a possible alternative correction."

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION

As indicated in Part II above, the Plan misapplied the required tax-gross up rules to Plan members who commenced receiving Plan benefits from January 1991 through September 2008 (for regular and disabled retirees and their survivors) and through December 2008 (for alternate payees and surviving ex-spouse members). This error resulted in the payment of about \$2.89 million in pension/death/disability benefits to 984 individuals (or about \$2,940 per overpaid recipient).

Upon discovery of the error, the Plan's administrative office immediately took steps to (1) ensure that all future benefit payments would be calculated using the correct "greater of" formula and (2) adjust the benefit payments of those individuals who were currently receiving benefit payments under the erroneous "blended" formula to conform with the Plan's statutory "greater of" formula.

In the Original VCP Application, the City requested a compliance statement based on prospective compliance steps described in the previous paragraph, but owing to the special character of the Plan (being a governmental plan that is funded on a pay-as-you-go ("PAYGO") basis, the application requested that the Plan not be required to pursue recovery of previously overpaid benefits — especially given the likelihood of litigation if recoupment of the previously overpaid benefits was attempted.

The IRS responded that the Original VCP Application would have to be revised to require attempted recoupment of the overpaid benefits using one of two recoupment methods — methods which are described in greater detail in the Revised VCP Application, which was the subject of the favorable 2010 Compliance Statement.

The approved recoupment methods were applied by the Plan and, as expected, a group of affected overpaid participants and beneficiaries filed a lawsuit against the Plan/City in mid-2011. The City filed counterclaims against the plaintiffs. Both sides have incurred significant legal costs in the course of prosecuting/defending the lawsuits, to date. Failing settlement, the City believes any decisions rendered on the lawsuits will be appealed to the Oregon Court of Appeals and, likely, the Oregon Supreme Court, meaning this matter will be tied up in litigation for years to come.

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

The parties were encouraged by the Circuit Court of the State of Oregon to seek settlement of the lawsuits. On February 5, 2013, the parties engaged in extensive settlement discussions in a session led by the Honorable Edward Levy, US Court of Appeals for the Ninth Circuit. As a result of these settlement discussions, the parties agreed to settle the claims as follows – contingent on the IRS approving the proposed settlement and granting a new Compliance Statement over the terms of the settlement approach.

The following lays out the actual method of correction that was proposed in the Revised VCP Application and approved in the 2010 Compliance Statement, the implementation of which precipitated the lawsuit discussed in Section II, above. See the discussion in Items A through C, below. The proposed modification of the approved correction, which is the reason for this VCP application, is found in Item D, below.

### A. Identification of Individuals from whom Recoupment was Sought

Classes from whom recoupment has been sought (estimated at 820 individuals):

- (i) Retired members with total overpayments in excess of \$500 who continue to receive retirement benefits as of the date recovery is sought; and
- (ii) Alternate Payees with total overpayments in excess of \$500 who continue to receive retirement benefits as of the date recovery is sought.

Classes from whom recoupment may (but is not required to) be sought (estimated at 164 individuals):

- (iii) Estates/survivors of deceased participants and/or alternate payees who died prior to the date the recovery is sought;
- (iv) Individuals whose overpayments were attributable to overpaid <u>disability</u> benefits (however, overpayments received by individuals who moved from disabled to retired status and who continue to receive such retirement benefits would be subject to recovery, to the extent of overpayments made on and after the date they moved from disabled to retired status); and

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

(v) Members/alternate payees whose total overpayments are \$500 or less, since the cost of recovery for these individuals likely will vastly outweigh the expected recovery for this particular class.

### **B.** Recoupment Methods

Two different possible methods were used to accomplish the required recoupment:

(1) <u>Actuarial Recoupment Method</u>. Recover the overpayment by actuarially amortizing it over each overpaid individual's remaining life expectancy. Using this approach, depending on an overpaid individual's age, it could take 25 to 30 years to fully recoup the overpayments. The overpayment will be deemed recovered once the actuarial adjustment is put in place.

Example: Assume that a retired member with a benefit of \$5,000 per month was overpaid \$3,500. Assume further that effective July 1, 2011, this member is 66 years old, and that the Plan's actuary determines that a \$17 per month reduction is required in order to actuarially recover the overpayment over the retired member's expected remaining lifetime. Starting July 1, 2011, the member's monthly benefit payment would be reduced by \$17 (i.e., to \$4,983) (with future adjustments made for COLAs and similar benefit adjustments as provided under the Charter).

(2) COLA Holdback Method. Recover the overpayment by holding back that individual's future annual COLA payments until the cumulative COLA payments equal the overpayment. Once the recoupment is completed, the individual's monthly benefit prospectively would "pop up" and revert back to the level it would have been but for the held-back COLA. In the event the overpaid individual dies prior to full recovery of the overpayment, the remaining overpayment shall be deemed to have been fully recovered.

**Example:** Assume that a retired member with a benefit of \$5,000 per month was overpaid \$3,500. Assume further that effective July 1, 2011, the Board exercises its discretion under the Charter to adjust retiree benefits for a 2% COLA. For the overpaid retiree, the 2011 COLA would be \$100 per month (2% times \$5,000 per

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

month). Starting July 1, 2011, this \$100 COLA adjustment would be retained by the Fund and, by June 30, 2012, \$1,200 of the \$3,500 overpayment will have been recovered. Assume further that effective July 1, 2012, the Fund exercises its discretion to adjust retiree benefits for another 2% COLA. For the overpaid retiree, the 2012 COLA would be \$102 (2% times \$5,100 per month). Starting July 1, 2012, a \$202 COLA adjustment would be retained by the Fund and by May 31, 2013, the entire \$3,500 overpayment will have been recovered. At that point, the overpaid retiree's monthly payment would "pop up" to include previously held-back COLA amounts (i.e., the monthly payment would increase by \$202 per month, to \$5,202).

### C. Application of Recoupment Methods

The overpaid individuals fall into one of two Plan categories: "FPDR One" (members who retired on or before January 1, 1990) and "FPDR Two" (members who were not retired or disabled as of January 1, 1990 and who were sworn in as officers/firefighters before January 1, 2007). Members who were sworn in on or after January 1, 2007 are "FPDR Three" members, whose pension benefits are not provided by the Plan but instead are provided under the Public Employee Retirement System for the State of Oregon ("OPERS").

### 1. FPDR One Recoupment: Actuarial Recoupment Method Only

As discussed below, benefits for FPDR Two members are eligible for consumer price index based discretionary COLAs pursuant to Section 5-312 of the Charter. FPDR One members' benefits, however, adjusted annually based not on a consumer price index (or similar) but instead on the current salary of a "First Class Fire Fighter or First Class Police Officer, as the case may be, computed annually at the beginning of [each] fiscal year." Section 5-120 of the Charter.

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# SECTION III, APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

Of the overpaid individuals, approximately 64 are FPDR One members – a significant percentage of which are deceased, and thus outside of the group of overpaid individuals from whom recovery will be sought. Since the Plan does not provide discretionary COLAs to FPDR One members, the recovery for FPDR One members will be achieved using the Actuarial Recoupment Method instead of the COLA Holdback Method (as those methods are described in subsection 2, above).

### 2. FPDR Two Recoupment: COLA Holdback or Actuarial Recoupment Methods

By contrast, FPDR Two members are eligible for annual COLAs. Specifically, for those FPDR Two members, Section 5-312 of the Charter provides for COLA-based "Benefit Adjustments" as follows:

Benefits payable under this Chapter shall be adjusted, where so indicated in the Section of this Article in which each benefit is described, in accordance with this Section after payment commences. The Board [of Trustees] shall determine the amount and timing of such adjustments in its discretion, except the percentage rate of change shall not exceed the percentage rate applied to retirement benefits payable to police and fire employees by the Public Employee Retirement System of the State of Oregon.

Emphasis supplied.

The percentage rate of change applied by OPERS is based on the Consumer Price Index for Portland-Salem (defined by All Items, All Urban Consumers, Portland-Salem, OR-WA, Annual Average) as published by the U.S. Department of Labor, Bureau of Labor and Statistics (the "CPI-Portland"). The maximum COLA for any given year is capped at 2.00%. If the CPI-Portland exceeds 2%, the CPI-Portland in excess of 2% is carried forward in a "bank" to be used in a future year, when the CPI-Portland is less than 2%. Where a participant does not have a balance in his or her COLA bank, then the COLA for a given year would be equal to the CPI-Portland for the year, if the CPI-Portland is less than 2%, otherwise the COLA would be 2%, with the excess carried forward in the Participant's COLA bank.

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

While COLA adjustments under the Fund are applied at the Board's discretion, in each of the past 21 years the Board has in fact applied the maximum permissible COLA to the benefits of FPDR Two retirees.

By way of further example, assume that the FPDR Two member's benefit at July 1, 2010 is \$5,000 per month (or \$60,000 per year), and that the member's overpayment totals \$5,000. Assume CPI-Portland for the next 5 years holds steady at 1% per year. Under Plan Section 5-312, the Board could apply the 1% CPI-Portland plus available banked COLA to provide for annual adjustments of up to 2% for each of these 5 years. The COLA that would otherwise apply effective starting July 1, 2011 (assuming the Board exercises its discretion to grant it) is \$100 (= 2% times \$5,000 per month). By July 1, 2012, the Fund will have recouped \$1,200 of the \$5,000 overpayment through the COLA Holdback. The COLA that would otherwise apply starting July 1, 2012 (again, assuming Board discretion granting the COLA) is \$102 (= 2% times (\$5,000 x 1.05)), so the monthly Holdback that would take effect starting July 1, 2012 is \$202 (= \$100 + \$102). This recoupment process is summarized in the following table:

				•					
Plan Year	CPI Portland	From COLA Bank	COLA Pct	Banked COLA EOY	Unadj. Mthly. Benefit	Mthly Benefit w/ COLA	Mthly Holdback	Ann Recoup.	Remaining Overpmt.
7/1/10	n/a		n/a	8.47%	5,000	5,000	0	0	5,000
7/1/11	1%	1%	2%	7.47%	5,000	5,100	100	1,200	3,800
7/1/12	1%	1%	2%	6.47%	5,000	5,202	202	2,424	1,376
7/1/13	1%	1%	2%	5.47%	5,000	5,306	306	1,376	0
7/1/14	1%	1%	2%	4.47%	5,000	5,412	0	0	0

### MODEL VCP SUBMISSION COMPLIANCE STATEMENT

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

As described in this table, recoupment via COLA Holdback Method would commence starting July 1, 2011 and the entire \$5,000 overpayment would be recouped by December 1, 2013. Once the overpayment is fully recouped, the member's monthly benefit would prospectively "pop up" by \$306 to include the held-back COLA amount. Thereafter, the member's benefit would be administered and paid as though the overpayment had never occurred.

Note: a \$5,000 overpayment amount was used in this example to show how the COLA Holdback Method would apply across multiple Plan Years. However, the average overpayment is \$2,940 – considerably less than the \$5,000 amount used in the example; applying the \$2,940 average overpayment to this example, full recoupment would be obtained by April 1, 2013.

However, if a FPDR Two member had no COLA as of July 1, 2011 from which to recoup the overpayment, then that FPDR Two Member's overpayment was instead corrected as though the member was an FPDR One member (i.e., recoupment will be via the Actuarial Recoupment Method).

Thus, while the COLA Holdback Method was the *preferred* corrective approach for FPDR Two members, it was <u>not</u> the exclusive approach that will be used to recoup overpayments made to those members. Accordingly, *if* an FPDR Two member would otherwise receive a COLA, then the COLA was instead credited towards the overpayment; however, if the FPDR Two member was for whatever reason ineligible to receive a COLA, then that member's overpayment was instead corrected via the Actuarial Recoupment Method. Either way, and in all cases, each overpaid member's monthly benefit payments were prospectively adjusted to recoup the overpayment.

D. Revised Method of Correction per Settlement Proposal: With respect to those overpaid individuals who are members of the class action lawsuit filed against the City/Plan, the amount of recovery from each such overpaid individual (as determined in the methodology described in Items A - C, above) would be capped at 60% of the overpaid amount. The two key provisions from the proposed settlement agreement that illustrate this revised correction method currently read as follows:

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# SECTION III. APPLICANT'S DESCRIPTION OF THE PROPOSED METHOD OF CORRECTION (continued)

"IT IS UNDERSTOOD AND AGREED that the recovery of the overpaid monies will continue with FPDR's methodology for recouping overpayments by holding back the Members' cost of living adjustments and/or actuarial reduction until the sixty percent (60%) recovery is achieved or until approval by the IRS of the new VCP Application, whichever is later.

\* \* \*

IT IS UNDERSTOOD AND AGREED that if FPDR has already recovered more than sixty percent (60%) of the overpaid benefits from any plaintiff or class member, the excess over sixty percent (60%) will be refunded to the plaintiff or class member."

As additional background, enclosed as part of this application is a letter dated April 23, 2013 from attorneys for plaintiffs in class action lawsuit regarding anticipated legal expenses of this case if the IRS does not approve the proposed settlement terms as codified in this VCP application.

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